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Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research & Planning Division

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Since the October meeting of the FOMC and Mr. Volcker's statements before the Joint Economic Committee in late November, the money markets have come to focus more on interest rate movements than on money supply. Thus the recent cut in the bank prime lending rate to 11% has been viewed as an indication that the Federal Reserve might reduce the discount rate soon. This logic, though broadly correct, points to a changed emphasis in the operations of the Federal Reserve. While this shift in emphasis is apparent, Mr. Volcker has tried to make clear that a shift in Federal Reserve policy has not occurred. What does this mean?

The Federal Reserve bases policy upon both abstract economic principles and economic realities. The new wrinkle in the Fed's intentions in late 1982 is best seen as putting several more steps between the conduct of monetary policy and strict monetarism. Yet the Fed's fight against inflation continues, and the primary intermediate operating target remains the nonborrowed reserves path that the Fed sets. Even as there is a growing concern by the Fed over the level of interest rates, policy rhetoric focuses on problems with the monetary aggregates and the necessary accommodations. As an intermediate target, M1 has become far less important.

In his address of November 24 to the Joint Economic Committee, the Chairman stressed the importance of the provision of bank reserves as an operating instrument. He also suggested that precautionary liquidity motives by the public should be accommodated to avoid an unintended tightening. This possible conflict, together with the problems posed for the monetary aggregates by the new accounts banks are allowed to offer, the super NOW account and the insured money market account, means that the Fed's likely reaction to above-target money growth is not clearly defined. The relatively greater weight placed on the monetary aggregate M2 is not too helpful because we only observe this aggregate once per month and because it is not itself free of distortions. On a day-to-day basis, the market has focused on movements in the Fed funds rate as policy. Indeed, the Fed funds rate has become remarkably stable.

While this view is too simplistic, it is roughly accurate. On the one hand, the Fed has little scope to allow interest rates to rise because of the weak state of the economy and the difficult international debt situation. In addition, the political cycle favors a lowering of interest rates. Yet the Fed wishes to keep from igniting another round of inflation. Only one action is consistent with these objectives: a slow downtrend in interest rates, at least until the economy begins to pick up. In terms of the monetary aggregates, any excessive monetary growth might be attributed to precautionary liquidity motives until the economy has shown some growth.

Prospects for success depend on developments in the real economy and in unemployment. Without some near-term improvement in economic activity, interest rates will have to be reduced somewhat faster than the Fed would like, posing an inflation risk. For now, however, the steady and slow course seems feasible. There has been enough strength in auto sales recently and other indicators to permit such an approach. Currently, the Fed is under no pressure, except from expectant market participants, for a discount rate cut. The Fed may choose to wait for further economic news; it might react sooner if M2 growth turns out to be slower than expected.

Robert A. Brusca

Irving Trust

Market Yields

	1/14/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.50%	15.75%
Effective since	1/11/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	12.00
Federal Funds	8.38	8.25	12.38
Repurchase Agreements	8.38	8.25	12.00
U.S. Treasury Issues			
Bills			
3 months	7.92	8.13	12.69
6 months	8.08	8.29	13.97
1 year	8.36	8.58	14.41
Coupons			
2 years	9.10	9.34	14.70
4 years	9.60	9.88	14.76
7 years	10.13	10.29	14.80
10 years	10.24	10.34	14.76
Long Bond	10.40	10.44	14.35
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.10	8.30	12.75
3 months	8.15	8.35	13.50
6 months	8.25	8.40	14.35
1 year	8.65	8.85	14.50
Banker's Acceptances			
1 month	8.05	8.25	12.65
3 months	8.10	8.30	13.45
6 months	8.30	8.40	14.35
Eurodollar Deposits			
1 month	8.75	8.88	13.44
2 months	8.75	8.88	13.81
3 months	8.75	8.88	14.00
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	7.88	6.00	12.50
1 month	8.00	8.00	12.50
3 months	8.13	8.25	12.63
Bank Holding Companies			
1 month	7.75	8.00	12.25
Dealer Placed:			
3 months	8.04	8.25	NA
New AA Corporate Utility Bond	12.35	12.25	17.25
Tax Exempt			
6 month Project Notes	4.40	4.65	7.50
1 year AAA Bond	4.50	5.25	8.25
5 year AAA Bond	6.15	6.20	9.50
20 year AAA Bond	8.60	8.90	12.30

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

Cable Address:
"IrvingBank" Telex: I.T.T. 420268 • R.C.A. 232241
W.U.I. 62832 • French 82629